Employment Contracts in India

Enforceability of Restrictive Covenants

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# Contents

1. **INTRODUCTION** 01

2. **RISE OF A ‘NEW BREED’ OF EMPLOYMENT RELATED DISPUTES IN INDIA** 02
   - I. Pre-Hire 02
   - II. During Employment 03
   - III. Termination 03
   - IV. Post Termination 03

3. **THE STATUS OF RESTRICTIVE COVENANTS IN INDIA** 05
   - I. Non-Competition Restriction 05
   - II. Non-Solicitation of Employees and Customers 06
   - III. Non-Disclosure of Confidential Information and Trade Secrets 08
   - IV. Distinction Between Trade Secrets and Confidential Information 10
   - V. Training Bonds 10
   - VI. Non-Poaching Agreements 11

4. **POSSIBLE WAYS TO ENFORCE RESTRICTIVE COVENANTS** 12

5. **EMERGING TRENDS** 13

6. **INDEX OF CASES** 14
1. Introduction

The employer-employee relationship is, and has always been, in a constant state of evolution. As the nature of this relationship evolves and changes, so does the nature of disputes that arise as a result of diverging interests which the employer and employees seek to protect in their interaction with each other and the society in general. Several laws and legislations have been drafted to create an appropriate framework to address these concerns with an objective to reasonably balance the interests of employers and employees. Such employment laws have a broad ambit and include within their scope all areas of the employer-employee relationship and are not merely restricted to contractual issues and/or workplace discrimination.

Globalization coupled with easy accessibility of advanced technology has had a phenomenal impact on the employer-employee relationship in India. The new economic policy announced in 1991 signaled a decisive shift in economic policies of the government from regulation to liberalization and the advent of various multinational companies has substantially changed the relationship between employers and employees and the disputes arising between them. While an increasingly liberalized market has promoted healthy competition between businesses, it has also resulted in accordance of significant importance to protection of innovative ideas, proprietary information, internal workings and mechanisms which lend firms the ‘competitive edge’ to thrive in the present economic environment. The objective to protect the ‘competitive advantage’ has in turn resulted in concerns of potential misuse of confidential and proprietary information of employers by employees, especially during, and post termination of, their employment.

With a distinctive cross border flavour in contemporary transactions, instances of organizations attempting to protect their trade secrets and confidential information manifest themselves in the use of ‘restrictive’ agreements between employers and employees, which place limitations and restrictions on the latter pertaining to the manner in which the employees are allowed to use and disseminate the information they become privy to solely as a consequence of being in the service of the employer.

When contrasted with the employees’ constitutional and statutory rights to pursue occupations of their choice and earn a livelihood, by using the full array of knowledge and skill at their disposal, the diverging interests sought to be advanced by employers (protection of confidential information to retain the ‘competitive edge’) promise to form a fertile ground for contentious disputes between the employers and employees in the near future.

This research publication focuses on the analysis of the legal framework existing in India to address such emerging concerns in the relationship between employers and employees along with developments through case laws.

The legislations governing several aspects of the employer-employee relationship are so numerous, complex and ambiguous, existing both at the national and state level, that they tend to promote litigation rather than providing easy solutions to potential problems. However, concerns of employers and employees relating to protection of confidential information, non-disclosure and non-solicitation have not yet been addressed through legislation in India, thus warranting recourse to judicial interpretation and common law. There is profound inconsistency within the judiciary itself when it comes to developing appropriate standards of review for addressing these emerging contentious employment related issues relating to confidentiality and non-solicitation.

This paper seeks to provide an overview of the scenarios where such disputes may arise between employers and employees, and highlights the need for formulation of a coherent legal framework within which to address such concerns. Further, this paper also assesses the validity of various restrictive covenants which are increasingly being incorporated in employment contracts.
2. Rise of A ‘New Breed’ of Employment Related Disputes in India

As we move towards a knowledge-based economy, the quest for formulation of a coherent and appropriate understanding of the ever evolving concept of industrial relations has become one of the most delicate and complex challenges. The disputes in the present context are not just applicable to the two classes that are the employees (labour) and the employer (management/owners), but also to a new workforce - the “White Collar”, a third class that has emerged as a result of adoption of a liberalized economic regime. The term ‘white-collar’ worker refers to a person who performs professional, managerial, or administrative work in contrast to a blue-collar worker, whose job requires manual labour.

The emergence of the new class has made the system more complex. In the past, the majority of the disputes arose between the workers/labourers or the unions comprising the working class and the employers were sought to be addressed through various enacted laws to protect the interests of the weak. These laws also envisioned resolution of disputes between the trade unions and the management for their rights, which were perpetrated either through strikes, bandhs or hartals.

However, as the complexities in the work field increased, disputes regarding payment terms, termination of service, breach of confidentiality, non-compete or non-solicitation clauses arose adding a new domain to the concept of industrial relations. The legal framework addressing the latter is still at a nascent stage of development in India. This Part discusses the situations where such disputes may arise between employers and employees at various stages of their relationship.

I. Pre-Hire

It is possible that disputes may arise even before a person is hired as an employee of a company. Cases where a new recruit has joined employment without duly terminating his agreement with the previous employer may pose risk of potential disputes. Such situations are also possible when a prospective or a newly hired employee has a post-termination obligation (which include non-disclosure of confidential information, non-solicitation, non-compete etc.) with an erstwhile employer which he or she may have breached. Typically, such disputes would arise between the erstwhile employer and employee. However, there have been instances where the prospective employer has also been dragged into litigation, by taking the position that the new employer is encouraging and assisting the employee to breach his obligations towards the previous employer.

Further, many companies have a pre-employment screening policy, with an objective to provide a degree of certainty that the potential employee does not have a criminal record involving dishonesty, or breach of trust involving his/her fiduciary or official capacity, or has not misused his/her official or fiduciary position to engage in a wrongful act including money laundering, etc. Such a screening policy may raise concerns of violation of the right to privacy of the persons being subjected to such screening as the mode and manner of collecting such information may violate rights of individuals guaranteed under Article 21 of the Indian Constitution.

The following scenarios may also give rise to pre hire employment disputes:

i. When the employer withdraws offer prior to employee’s joining.

ii. When the employee’s background check results are unsatisfactory or the employee provides incorrect disclosures or misrepresents to the prospective employer.

To reduce litigation risk, it is also helpful to obtain a representation from the new employee (whether under the employment contract or otherwise) that the employee has not and will not breach any obligations towards his previous employer, as a result of joining the employment of the new employer.

II. During Employment

During the course of employment, several disputes may arise between the employer and the employee. These can be broadly summed up in 2 categories:

A. Employment Related Disputes

Misconduct or indiscipline of an employee, insider trading, indulging in criminal activities, under-performance, breach of the terms of the employment contract or HR policies/code of conduct etc., are few of the contentious issues which may ultimately lead to a dispute.

B. Disputes Relating to Restrictive Covenants During Employment

There are broadly two kinds of restrictive covenants in operation during the term of employment which are non-compete and non-disclosure of confidential information.

If the employee is in breach of a non-compete restriction, prohibiting the employee from engaging in any kind of business or activity which is similar to the company’s business, or a mandate to not disclose or misuse confidential information or trade secrets passed on to the employee, during the course of his employment, such breaches would inevitably lead to a potential dispute.

III. Termination

In cases where the employee voluntarily resigns or retires from employment, it is unlikely that there will be a dispute (unless there are elements of a breach being committed by the employee).

In contrast, termination of employment by the employer often leads to a stand-off between an employee and employer which has all the ingredients for baking a potential dispute. Termination of employment due to misconduct, breach of the employment agreement including violation of restrictive covenants therein, is often escalated and settled through resort to courts.

An important factor to be considered in a dispute relating to termination of employment by the employer is whether the employee being so terminated enjoys statutory protection of employment such as a “workman” as defined in the Industrial Disputes Act, 1947 (“IDA”) and/or protection under the state specific labour laws such as the Shops and Establishments Act. The IDA also contains unfair labour practices on the part of the employer.

If the employee does enjoy such protection, then before terminating the employment of such an employee for any of the above reasons, the employer would have to serve the employee with at least a 30 days’ notice or pay salary in lieu thereof.

The procedure to be followed for termination due to ‘misconduct’ would involve framing of charges and issuance of a charge sheet, conducting an internal (domestic) enquiry by an unbiased inquiry officer, followed by issuance of a show cause notice. The process needs to be followed as per the principles of natural justice and the employee should be given an opportunity to submit his defence and call upon witnesses. Decision to terminate employment should be taken depending on the gravity of the misconduct on the part of the employee.

IV. Post Termination

Covenants restraining employees from joining competitors even after the cessation of employment are often found in modern day employment contracts. Restrictions in this category may also prevent a former employee from starting a competing business or even advising a family member or relative who is in a similar line of business.

A breach of post termination clauses often forces the employer to seek advice on the legal recourse available to it.

Indian courts however prioritize the protection of rights of an employee seeking employment over protecting the interests of the employer seeking to protect itself from competition. In view of the Constitution of India and the provisions of the Indian Contract Act, 1872, (“Contract Act”) courts have generally held that the right to livelihood of the employees must prevail in spite of an existing agreement between the employer and the employee.

Further, courts frown upon any form of post-employment restraint as restraint is considered to reduce the economic mobility of the employees, thereby limiting their personal freedom of choice of work/livelihood. The underlying reasoning behind invalidating post-employment restraints is that if
such restraints were permitted, the employee would be unfairly restrained from using the skills and knowledge gained, to advance further in the industry precisely because of such increased expertise.

The validity of such restrictive covenants is tested on the standards of reasonability - involving considerations of duration and space of the restriction in question. The following part discusses the scope and interpretation of such restrictive covenants within the Indian legal framework.

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3. The Status of Restrictive Covenants in India

Incorporation and subsequent enforcement of ‘restrictive covenants’ such as confidentiality, non-disclosure and non-solicitation in employment contracts, intended to restrict the employees from disseminating confidential and other important information exclusively available with an employer, are often contentious issues in India because such provisions seemingly conflict with Section 27 of the Contract Act.

I. Non-Competition Restriction

An agreement in restraint of trade has been defined as “one in which a party agrees with any other party to restrict his liberty in the future to carry on trade with other persons who are not parties to the contract in such a manner as he chooses.” As an exception to this general rule, agreements under which one party sells his goodwill to another, while agreeing not to carry on a similar business within specified local limits, are valid, provided such agreements appear to the court to be reasonable.

Article 19 (g) of the Constitution of India clearly provides every citizen the right to practice any profession, trade or business. This is not an absolute right and reasonable restrictions can be placed on this right in the interest of the public; the courts have always been wary of upholding such restrictions and have kept the interpretation of this provision flexible so as to ensure that principles of justice, morality and fairness are aptly applied, depending upon the facts and circumstances of each case.

Employers often tend to incorporate restrictive covenants in the agreement to protect their confidential information and trade secrets as well as their growing business. For any restrictive covenant to fall within the ambit of Section 27 of the Contract Act, the agreement has to be in restraint of trade. Unlike the law in the United Kingdom, the Contract Act does not distinguish between partial and total restraint of trade, if the clause amounts to restraint post termination of the agreement, then the same is void. Section 27 itself is succinct and doesn’t offer insight as to what kinds of restraints are valid; the qualification of ‘reasonable’ restraints being valid and enforceable has been read into Section 27 by the courts.

To determine whether a restrictive covenant in employment contract would be reasonable and valid or not, the courts have paid due regard to bargaining power of each party, reasonableness of restrictions set out in the covenant, time, place and manner of restriction etc.

In India, due to the heavy bargaining power of the employers, the trend is for the courts to protect the rights of the employee and adopt an interpretation favourable to the employee.

Section 27 of the Contract Act has been applied in the context of (1) employer - employee contracts, (2) contracts with partners, (3) dealer contracts and (4) miscellaneous cases.

While it is a settled position of law that restrictive agreements bind current employees in lawful employment of the employer throughout the duration of the contract, the position of law regarding validity of such restraints on employees after termination of contract is more contentious and adjudicated before courts.

The Supreme Court of India (“Supreme Court”) in Niranjan Shankar Golikari v. Century Spg & Mfg Co. Ltd enumerated the tests to determine the validity of ‘restrictive’ agreements in terms of Section 27 of the Contract Act. In this case, a foreign producer collaborated with a company manufacturing tyre cord yarn by an agreement which stated that the company would maintain secrecy of all technical information. In pursuance of the agreement, the company signed a non-disclosure agreement with the appellant, at the time of his employment.

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3. Section 27 of the Contract Act provides that ‘every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.’

**Exception 1:** Saving of agreement not to carry on business of which good will is sold - One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein, provided that such limits appear to the court reasonable, regard being had to the nature of the business.

7. AIR 1967 SC 1098.
The Supreme Court observed as thus:

“...considerations against restrictive covenants are different in cases where the restriction is to apply during the period after the termination of the contract than those in cases where it is to operate during the period of the contract. Negative covenants operative during the period of the contract of employment when the employee is bound to serve his employer exclusively are generally not regarded as restraint of trade and therefore do not fall under section 27 of the Contract Act. A negative covenant that the employee would not engage himself in a trade or business or would not get himself employed by any other master for whom he would perform similar or substantially similar duties is not therefore a restraint of trade unless the contract as aforesaid is unconscionable or excessively harsh or unreasonable or one sided...”

In light of such observations, the agreement was held to be valid and the appellant was accordingly restrained from serving anywhere else for the duration of the agreement. The Supreme Court held that there is an implied term in a contract of employment that a former employee may not make use of his former employer's trade secrets. Subject to this exception, the employee is entitled to exploit the full range of the knowledge and skill possessed by him/her. The Supreme Court relied on Lord Halsbury's Laws of England which stated that as a general principle an individual was entitled to exercise his lawful trade or calling as and when he wills and that the law had jealously guarded against interference with trade even at the risk of interference with freedom of contract, as it was public policy to oppose all restraints upon liberty of individual action which are injurious to interests of trade. This principle was based on public policy, which is a dynamic concept that changes and evolves based on times and needs.

Recently in Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan & Anr it was held by the Supreme Court that “...a restrictive covenant extending beyond the term of the contract is void and not enforceable”. The Supreme Court also held that “the doctrine of restraint of trade does not apply during the continuance of the contract for employment and it applied only when the contract comes to an end.” The Supreme Court further went on to observe that the doctrine of restraint of trade “is not confined only to contracts of employment, but is also applicable to all other contracts”.9

Although Section 27 states that all agreements in restraint of any profession, are void, so long as an employee does not have the motive to cheat, mistrust or cause irreplaceable loss to the company, trade or business reasonable restraints are permitted and do not render the contract void.

The next part of the paper discusses the applicability of non-solicitation, non-disclosure and confidentiality clauses at length.

II. Non-Solicitation of Employees and Customers

A non-solicitation clause prevents an employee or a former employee from indulging in business with the company’s employees or customers against the interest of the company. For example, an employee agrees not to solicit the employees or clients of the company for his own benefit during or after his employment.

Non-solicitation obligations have been enforced in some circumstances, albeit on a case by case basis. For instance, in Desiccant Rotors International Pvt. Ltd v Bappadiitya Sarkar & Anr.10, the Delhi High Court allowed an injunction against the manager prohibiting him from soliciting Desiccant's customers and suppliers to stand in effect. It is pertinent to note, however, that the Delhi High Court held that a marketing manager could not be deemed to possess confidential information and that his written declaration to that effect in his employment agreement was meaningless and thus rejected Desiccant's claim to enforce the confidentiality obligations on the manager.

Further, in FLSmidth Pvt.Ltd. v M/s.Secan Invescast (India) Pvt.Ltd.11 (“Secan Invescast”) the Madras High Court held that merely approaching customers of a previous employer does not amount to solicitation until orders are placed by such customers based on

8. AIR 2006 SC 3426.
such approach. The Madras High Court laid down the standard to establish non-solicitation:

“...solicitation is essentially a question of fact. The appellant should prove that the respondent approached their erstwhile customers and only on account of such solicitation, customers placed orders with the respondent. Mere production of quotation would not serve the purpose. It is not as if the appellant is without any remedy. In case the Court ultimately holds that the appellant has got a case on merits, they can be compensated by awarding damages. The supplies made by the respondent to the erstwhile customers of the appellant would be borne out by records. There would be no difficulty to the appellant to prove that in spite of entering into a non-disclosure agreement, respondent have solicited customers and pursuant to such solicitation they have actually supplied castings. When there is such an alternative remedy, question of issuing a prohibitory injunction does not arise.”

The Secan Invescast judgment states that such clauses may be valid if reasonable restrictions such as distance, time limit (reasonable time frame), protection and non-usage of trade secrets and goodwill are imposed on former employees.

The increasing significance of protecting client information is brought out in Embee Software Pvt. Ltd. v. Samir Kumar Shaw, wherein the Calcutta High Court has recently held that ‘acts of soliciting committed by former employees takes such active form that it induces the customers of the former employer to break their contract with the former employer and enter into a contract with the former employee, or prevents other persons from entering into contracts with the former employer’ cannot be permitted. This decision echoes the decision in Crowson Fabrics Ltd. v. Rider, wherein the court highlighted the following salient aspects in this context:

i. Negative covenants tied up with positive covenants during the subsistence of a contact be it of employment, partnership, commerce, agency or the like, would not normally be regarded as being in restraint of trade, business or profession unless the same are unconscionable or wholly one-sided;

ii. Negative covenants between employer and employee contracts pertaining to the period post termination and restricting an employee’s right to seek employment and/or to do business in the same field as the employer would be in restraint of trade and, therefore, a stipulation to this effect in the contract would be void. In other words, no employee can be confronted with the situation where he has to either work for the present employer or be forced to idleness;

iii. While construing a restrictive or negative covenant and for determining whether such covenant is in restraint of trade, business or profession or not, the courts take a stricter view in employer-employee contracts than in other contracts, such as partnership contracts, collaboration contracts, franchise contracts, agency/distributorship contracts, commercial contracts. The reason being that in the latter kind of contracts, the parties are expected to have dealt with each other on more or less an equal footing.
whereas in employer-employee contracts, the norm is that the employer has an advantage over the employee and it is quite often the case that employees have to sign standard form contracts or not be employed at all;

iv. The question of reasonableness as also the question of whether the restraint is partial or complete is not required to be considered at all whenever an issue arises as to whether a particular term of a contract is or is not in restraint of trade, business or profession."

In *GEA Energy System India Ltd. v. Germanischer Lloyd Aktiengesellschaft*, the Madras High Court had occasion to consider the operation of Section 27 in the context of two joint venture partners. In this case, Defendant had terminated the Joint Venture Agreement (‘Agreement’) and Plaintiff sought to restrain Defendant from carrying on a similar business in India. Although there were several other issues, the High Court examined the contention of the parties with regard to restraining Defendant from carrying on business in India and its legality in the context of Section 27 of the Contract Act.

The Madras High Court observed that the restrictive clause only stated that Defendant may not carry on a business which is prejudicial to the Plaintiff company and as such did not restrict the Defendant in absolute terms from carrying on any business. The Madras High Court further noted that the parties entered into the Agreement of their own free will and as per the terms of the Agreement, had equal bargaining power. The terms were not one-sided and did not betray weakness of any one party. It would thus be seen that the same test as is applicable in the context of employment contracts, is substantially applicable even in the context of joint venture agreements.

III. Non- Disclosure of Confidential Information and Trade Secrets

The employee is mandated to take reasonable steps to keep all the confidential information in confidence except and to the extent when disclosure is mandatory under any law in force. The employee further agrees that he shall not discuss or disclose the confidential information of the company to any person or business unrelated to the company.

In *Escorts Const. Ltd v. Action Const.*[15], the Delhi High Court restrained Escorts from manufacturing, selling or offering for sale the Pick-N-Carry Mobile Cranes that were a substantial imitation or reproduction of the industrial drawings of the Plaintiffs, or from using in any other manner whatsoever, the technical know-how. In *Burlington Home Shopping Pvt. Ltd. v. Rajnish Chibber*, the Delhi High Court again restrained carrying on of any business including mail order business by utilizing the list of clientele/customers included in the database of the petitioner.

In *Diljeet Titus v. Mr. Alfred A. Adebare and Others*, the defendant, an advocate, was working at the plaintiff's law firm. On termination of employment, the defendant took away important confidential business data, such as client lists and proprietary drafts, belonging to the plaintiff. The defendants contended that, they were the owners of the copyright work as it was done by them during their employment since the relation between parties was not that of an employer and employee. The Delhi High Court rejected this contention and ruled that the plaintiff had a clear right in the material taken away by the defendant. Accordingly, the Delhi High Court restrained the defendant from using the information taken away illegally. It should be noted that the Delhi High Court did not prohibit the defendants from carrying on a similar service. The defendants were only restrained from using the information they took, as this was necessary to protect the interests of the plaintiff.[16] The relationship between the parties was in the nature of a contract of service.

In *American Express Bank Ltd. v. Ms. Priya Puri*, the defendant was working as the Head of Wealth Management for the plaintiff bank for the North India region. Upon the defendant serving her notice for termination of employment, the plaintiff bank instituted allegations of sharing trade secrets, confidential information and possessing intellectual property of the plaintiff. The plaintiff consequently filed a plea for injunction against the defendant. The
Delhi High Court rejected this plea on the grounds that “The inconvenience caused to the defendant shall be much more in case the injunction as prayed by the plaintiff is granted in his favour”.

The Delhi High Court further observed that in order to claim copyrights, the plaintiff should have abridged, arranged and/or done something “which would show that they have done something with the material which is available in public domain so as to claim exclusive rights in that”.

In addition to restraining employees from using such confidential information post termination, by way of seeking injunction or claiming damages, the criminal legislation also comes to the aid of employers and provides them with an opportunity to take criminal action against the employees in addition to seeking civil remedies. Several provisions of the Indian Penal Code (“IPC”)\(^2\) and Information Technology Act, 2000 are also attracted in case of breach of confidentiality and disclosure provisions and allow criminal prosecution and imprisonment or fine or both as required with increasing dependence on technology, remedies have been provided under the Information Technology Act, 2000 to deal with hacking (Section 66); causing damage to computer system (Section 43); tampering with computer source document (Section 65); punishment for violation of privacy policy (Section 66E); etc.; may also be considered by the employer as remedies against the employee in case of breach of confidentiality and disclosure provisions.

In *Pyarelal Bhargava v. State of Rajasthan*\(^2\), an employee was convicted for theft under Section 378 of IPC. The employee had removed certain confidential information from the government department and had passed it to a friend who in turn had substituted the documents. This friend further removed certain documents while substituting them with others. Thereafter, the file was returned the next day. The Supreme Court held that even temporary removal of documents with a dishonest intention could cause loss or harm and hence, would be considered theft.

In *Abhinav Gupta v. State of Haryana*\(^9\), the accused, an ex-employee of Company A had resigned and joined Company B after final clearance from Company A. During his course of exit interview he had continuously maintained that he would not be joining any company which was in direct competition with Company A. He also agreed that all the confidential information acquired by him during his tenure at work shall be kept confidential at all times. However, two weeks later, it came to the knowledge of Company A that he had joined Company B, which was its direct competitor. Later, it was also discovered that the accused had transferred or downloaded various confidential information of Company A into his personal e-mail id. Screenshots of the mail id of the accused was produced by Company A which showed that such information was passed on to Company B. Thus, the Court was of the view that such act amounted to hacking under Section 66 of the Information Technology Act, 2000; cheating and dishonestly inducing of property under Section 420 of IPC and also amounted to criminal breach of trust under Section 406 of IPC.

The uncertainty of the judicial decision’s over the non-compete clauses has resulted in the corporate industry developing and taking recourse to a concept called “garden leave”, having its genesis in England\(^4\), under which employees are paid their full salary during the period in which they are restrained from competing.

However, when the validity of “garden leave” clauses came for consideration before the Bombay High Court it was argued that “the Garden Leave Clause is... *prima facie* in restraint of trade and is hit by Section 27 of the Contract Act. The effect of the clause is to prohibit the employee from taking up any employment during the period of three months on the cessation of the employment”. The Court, accepting the argument, held that obstructing “an employee who has left service from obtaining gainful employment elsewhere is not fair or proper”\(^5\).

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21. IPC provisions like Section 381 (Theft by clerk or servant which is punishable with imprisonment which may extend to 7 years and fine); Section 405 (Dishonest misappropriation of property which is punishable with imprisonment which may extend to 2 years or fine or both); Section 405 (Criminal breach of trust which is punishable with imprisonment which may extend to 3 years or fine or both); Section 408 (Criminal breach of trust by a clerk or servant which is punishable with imprisonment which may extend to 7 years and fine); Section 415 (Cheating which is punishable with imprisonment which may extend to 1 year or fine or both); can also be resorted to by the employers in case of breach of confidentiality on part of the employees post-employment period.

22. AIR 1963 SC 1094

23. 2008 CrI1 4356

24. *Evening Standard Co. Ltd. v. Henderson,* [1987] I.L.R.R. 64. (This case is credited with giving rise to the concept of garden leave. The court found that Henderson “ought not, pending trial, to be allowed to do the very thing which his contract was intended to stop him doing, namely working for somebody else during the period of his contract.”)

25. VFS Global Services Private Limited v. Mr. Suprit Roy, 2008 (2) Bom. CR 446, 2008 (3) MhI 1 266.
IV. Distinction Between Trade Secrets and Confidential Information

Information may be classified as a trade secret if such information is exclusively available to a particular business, not available in the public domain and allows that business to obtain an economic advantage over its competitors. Secret processes of manufacture, methods of construction, customer databases and business plans may constitute trade secrets. Trade secrets enjoy protection of the law both during and after termination of employment.

In *Polymer Papers Limited v. Gurmint Singh & Ors.*, the Delhi High Court considered a case wherein Plaintiff sought to restrain an employee from disclosing certain trade secrets on the basis of rights claimed under intellectual property law even though there was no agreement between the parties. The Defendant had earlier worked with the Plaintiff company and later joined a competing venture. The Plaintiff had alleged that the Defendant was revealing trade secrets and other confidential information related to certain products in respect of which Plaintiff had exclusive rights and Defendant had thus committed breach. However, as per the facts as substantiated before the Delhi High Court, there was no agreement between Plaintiff and Defendant and further, Plaintiff had not made disclosure of material facts and had also not concealed information relating to the relation between Plaintiff and the competing company that Defendant had joined. Consequently, the Delhi High Court held that in any event, Plaintiff was not entitled to discretionary relief of injunction. The Delhi High Court further held that Plaintiff did not possess any exclusive intellectual property rights in respect of the products in dispute and hence there was no ground on which Plaintiff was entitled to injunction.

However, there may be other information particular to a business which is highly important, confidential and instrumental to the success of that business. Affording protection to such information is a more complicated exercise. In *Faccenda Chicken Ltd v. Fowler*, the English Court of Appeal classified ‘confidential information’ into the following two categories: ‘highly confidential information’, which are entitled to protection after the termination of the employment relationship, and ‘less confidential information’ which are not so entitled.

In creating the trinity of ‘trade secrets’, ‘highly confidential information’ and ‘less confidential information’, the Court came up with a new challenge for other courts to identify where an employee’s general knowledge ends and where the employee’s confidentiality begins. India does not have a concrete legislation with respect to trade secrets and therefore companies in India have to rely on such agreements to protect its trade secrets.

It is interesting to note that even countries that have a statute with respect to the protection of trade secrets often rely on the necessity of non-compete agreements. In the recently celebrated case of *Microsoft v. Google*, Microsoft alleged that Kai-fu Lee who had intimate knowledge of the company’s trade secrets had violated a non-compete agreement by defecting to Google.

V. Training Bonds

The employer to protect and safeguard its interest often executes a training bond with its employees for training imparted and/or provided during the course of their employment or specifically provided prior to joining, to ensure that they work for a particular duration. These bonds specify the minimum period for which the employee shall serve the employer though such clauses may not be enforceable in the Indian context. If the employee acts in breach of such an agreement, the employer can seek compensation, at times limited to the expenses incurred for training the employee. However, the compensation awarded should be reasonable and not imposed by way of a penalty. The employer is entitled only to reasonable compensation based on facts and circumstances of the case. The sole purpose of such contracts is to ensure that the resources and time of employers are not rendered meaningless in training with no benefits derived whatsoever due to early resignation.

In *Satyam Computer Services Limited v. Ladella Ravichander*, the Defendant was an employee who had abruptly left the company and as per terms of

26. AIR 2002 Del 530
28. *Coin A Matic (Pacific) Ltd v Sabil et al*, (1986), 13 CCEL 59 (BSCC) (the Court held that solicitation of the ex-employer’s clients was part of a permissible general solicitation as it is obtained through ‘less confidential information’); *White Oaks Welding Supplies v Tapp* (1987), 41 OR (2d) 445 (HC).
30. MANU/AP/0416/2011
employment bond, was to pay liquidated damages of Rs. 200,000 along with stipend charges and additional expenses incurred by the company for the Defendant. However, the Andhra Pradesh High Court held that such action by the Defendant did not cause any damage or loss to the company and it would be unreasonable to acquire such amount from the Defendant. An amount of Rs. 100,000 was fixed by the court as reasonable damages taking into consideration the period of work and the fact that no actual loss was caused to the Company.

Similarly, in *M/s Sicpa India Limited v. Shri Manas Pratim Deb*[^31^], the employee had to enter into two bonds, one which provided that the employee had to work for a period of five years or pay an amount of Rs. 200,000 and another which stated that the expenditure on business trip would be recouped from the services of the employee. The employee resigned from the company towards the end of five years of his bond period. The company instructed the employee to pay certain amounts for medical expenses incurred by the company on behalf of the employee. The employee refused to pay the amount as it was unreasonable and the matter was taken up to the court where it was held that the five years mentioned in the first bond was almost towards the end and Rs. 67,596 was already recouped from the services of the employee for the second bond. Therefore, taking into consideration the period left in the bond, the court awarded reasonable damages to the employer.

In *Toshnial Brothers (Pvt.) Ltd. v. E. Eswarprasad & Ors.*[^32^] the Madras High Court dealt with a situation where an employee working as Sales Engineer in breach of his undertaking left his services within 14 months as against the contractually agreed period of three years. The Madras High Court held that the employer was entitled to recover the stipulated damages, which is a genuine pre-estimate by the parties of the damages incurred. There is no requirement to prove separately any post-breach damages. The employer is required to establish that the employee was the beneficiary of special favour or concession or training at the cost and expense wholly or in part of the employer and there had been a breach of the undertaking by the beneficiary of the same. In such cases, the breach would per se constitute the required legal injury resulting for the employer due to breach of the contract.

VI. Non-Poaching Agreements

Whilst non-compete, non-solicitation and non-disclosure agreements deal with the employer-employee relationship, a fourth class of restrictive agreement which are often signed by the parties is the non-poaching agreement which is executed between two employers. In an age of constantly evolving specialized industries and niche talent pools, employers often tend to invest a very large amount of human capital into their employees. If these employees subsequently join direct competitors, it can result in substantial economic loss for the ex-employer. A non-poaching agreement therefore enforces guidelines to be followed in cases of lateral hiring.

This type of agreement essentially considers the case wherein two organizations/companies agree not to solicit or ‘poach’ the employees of their direct competitors - Non-poaching agreement per se does not contravene section 27 of the Contract Act as it does not restrain an employee from seeking and/or applying for any job/employment. What this class of agreement does instead is it simply mandates that one competitor should seek the consent of the other before hiring that other competitors’ employee/s.

However, non-poaching agreements have been thought to enhance non-competitive behavior in the market place. This was the view adopted by the Department of Justice in the USA in 2009 wherein investigations were initiated into companies who had signed non-poaching agreements. In India, the law regarding section 27 of the Contract Act is well settled as has been previously discussed. However, the issue of non-poaching agreements now also comes within the ambit of the Competition Act, 2002. Whilst no cases have been considered exclusively in connection with non-poaching agreements under the Competition Act so far, Section 3 expressly states that agreements which are anti-competitive in nature are banned. However, so long as non-poaching agreements prescribe guidelines for lateral hiring and do not outright ban this practice, they are not thought to be in contravention of section 3.

[^31^]: MANU/DE/6554/2011
[^32^]: 1997 LLR 500
4. Possible Ways to Enforce Restrictive Covenants

i. Serve the employee with a Legal Notice

ii. Seek enforcement of undertaking or encashment of cheque based on clauses of the agreement

iii. Initiate civil suit seeking injunction/specific performance of contract as well as damages. While damages are a remedy that an employer may seek for breach of employment contract, including breach of confidential agreements, the same requires trial and evidence. Therefore, the employer once again would require only injunction under Order XXXIX Rule 1 and 2 of the Code of Civil Procedure, 1908 (CPC) at the interim stage or initially if they apprehend that premature departure of an employee could cause injury to the employer.

iv. Suit for declaration that the acts of the employee amount to tortious interference in the business of the employer and injunction therefrom.33

33. Embee Software Private Ltd v. Samir Kumar Shaw & Ors. 2012(3)CHN250
5. Emerging Trends

The discussion above on Section 27 of the Contract Act clearly states that restraints can be enforced only when the employee is in the service of the employer and these restraints cannot be enforced after the employee leaves service of the employer – irrespective of whether the employee leaves voluntarily or as a result of his services being terminated. However, the only restrictions that would be enforceable in an Indian court after the termination of employment would be non-disclosure of confidential information and non-solicitation of customers and employees.

In *Gujarat Bottling v. Coca Cola*, the Supreme Court observed:

“…..In the past nations often went to war for the protection and advancement of their economic interests. Things have changed now. Under the international order envisaged by the Charter of the United Nations war is no longer an instrument of State policy. Now-a-days there are wars between corporations, more particularly corporations having multi-national operations, for the protection and advancement of their economic interests. These wars are fought on the economic plane but some of the battles spill over to courts of law…..”

In the time of cut throat competition and high employee turnover rate, the employers usually try to protect their trade secrets and in order to compete in the market, make their employees sign contracts/agreements which restrain their employees from disclosing the job profile, in future, or from competing with the same establishment or from working with the competitors. These agreements entered between the employer and the employee should not hamper the growth of employee as well as secure the interests of the employer. The approach used by the Supreme Court in *Percept D’Mark (India) Pvt. Ltd. v. Zaheer Khan & Anr* seems to be the most appropriate approach to address concerns arising out of restrictive covenants:

“…..Somewhere there must be a line between those contracts which are in restraint of trade and whose reasonableness can, therefore, be considered by the courts, and those contracts which merely regulate the normal commercial relations between the parties and are, therefore, free from doctrine…..”

The relevance of inserting restrictive covenants in all kinds of contracts has evolved over a period and gained significant importance specifically due to growing trend of employer-employee disputes. The Law Commission of India in its 13th Report in 1958 had recommended that Section 27 under the Contract Act be amended to include only agreements in restraint of trade that are unreasonable or in the interests of public to be void, however till date no such amendment has taken place. Restrictive covenants need to be analysed on a case-to-case basis. While broad principles emerge from the rulings, whether a condition is violative or not is a question of fact which only a court of law can examine and arrive at an appropriate conclusion based on facts and circumstances.

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34. Supra at fn 6
35. AIR1995 SC 2372.
36. AIR 2006 SC 3426.
# Index of Cases

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Cases</th>
<th>Relevant Paragraphs</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Petrofina (Great Britain) v. Martin, (1966) Ch. 146.</td>
<td>An agreement in restraint of trade is one in which a party agrees with any other party to restrict his liberty in the future to carry on trade with other persons who are not parties to the contract in such a manner as he chooses.</td>
<td>5</td>
</tr>
<tr>
<td>2.</td>
<td>Niranjan Shankar Golikari v. The Century Spinning Mfg. Co. Ltd. (1967)2 SCR 378.</td>
<td>Section 27 itself is succinct and doesn’t offer insight as to what kinds of restraints are valid; the qualification of ‘reasonable’ restraints being valid and enforceable has been read into Section 27 by the courts. Considerations against restrictive covenants are different in cases where the restriction is to apply during the period after the termination of the contract than those in cases where it is to operate during the period of the contract. Negative covenants operative during the period of the contract of employment when the employee is bound to serve his employer exclusively are generally not regarded as restraint of trade and therefore do not fall under section 27 of the Contract Act.</td>
<td>5</td>
</tr>
<tr>
<td>4.</td>
<td>Percept D'Mark (India) Pvt. Ltd. v. Zalheer Khan &amp; Anr; AIR 2006 SC 3426.</td>
<td>Under Section 27 of the Contract Act (a) a restrictive covenant extending beyond the term of the contract is void and not enforceable. (b) The doctrine of restraint of trade does not apply during the continuance of the contract for employment and it applied only when the contract comes to an end. Somewhere there must be a line between those contracts which are in restraint of trade and whose reasonableness can, therefore, be considered by the courts, and those contracts which merely regulate the normal commercial relations between the parties and are, therefore, free from doctrine.</td>
<td>6, 13</td>
</tr>
<tr>
<td>5.</td>
<td>Desiccant Rotors International Pvt Ltd v Bappaditya Sarkar &amp; Anr., Delhi HC, CS (OS) No. 337/2008 (decided on July 14, 2009).</td>
<td>Court allowed an injunction against the manager prohibiting him from soliciting Desiccant’s customers and suppliers to stand in effect. It is pertinent to note, however, that the Court held that a marketing manager could not be deemed to possess confidential information and that his written declaration to that effect in his employment agreement was meaningless and thus rejected Desiccant’s claim to enforce the confidentiality obligations on the manager.</td>
<td>6</td>
</tr>
<tr>
<td>6.</td>
<td>M/s.FLSmidth Pvt.Ltd. v M/s. Secan Invescast (India) Pvt. Ltd., (2013) 1 CTC 886.</td>
<td>Approaching customers of a previous employer does not amount to solicitation until orders are placed by such customers based on such approach. Test for solicitation: It needs to be proved that erstwhile customers were approached and only on account of such solicitation, customers placed orders with the respondent. Mere production of quotation would not serve the purpose. It is not as if the appellant is without any remedy. In case the Court ultimately holds that the appellant has got a case on merits, they can be compensated by awarding damages.</td>
<td>6</td>
</tr>
<tr>
<td>7.</td>
<td>Embee Software Pvt. Ltd. v. Samir Kumar Shaw, AIR 2012 Cal 141.</td>
<td>If the act of soliciting by the respondents takes such an active form that it induces the customers of the plaintiff to break their contract with the plaintiff and enter into a contract with the said respondents or the fourth respondent or prevents other persons from entering</td>
<td>7, 12</td>
</tr>
</tbody>
</table>
into a contract with the plaintiff, such acts of soliciting cannot be permitted.

Suit for declaration that the acts of the employee amount to tortious interference in the business of the employer and injunction therefrom.


Even though the act of retaining various documents belonging to the ex-employer concerning customer and supplier contact details by the employees during employment did not amount to a breach of confidentiality, such ‘illegitimate’ actions constituted a breach of employees’ duty of fidelity.

9. Wipro Ltd. v. Beckman Coulter International SA., 2006 (3) ARBLR 118 (Delhi)

Stricter view for employee-employer contracts: The reason being that in the latter kind of contracts, the parties are expected to have dealt with each other on more or less an equal footing, whereas in employer-employee contracts, the norm is that the employer has an advantage over the employee and it is quite often the case that employees have to sign standard form contracts or not be employed at all.

10. GEA Energy System India Ltd. v. Germanischer Lloyd Aktiengesellschaft, [2009]149CompCas689(Mad)

The restrictive clause only stated that Defendant may not carry on a business which is prejudicial to the Plaintiff company and as such did not restrict the Defendant in absolute terms from carrying on any business. The Madras High Court further noted that the parties entered into the Agreement of their own free will and as per the terms of the Agreement, had equal bargaining power. The terms were not one-sided and did not betray weakness of any one party. It would thus be seen that the same test as is applicable in the context of employment contracts, is substantially applicable even in the context of joint venture agreements.


[Former Employees carrying out similar business] Restrained from using Substantial imitation or reproduction of the industrial drawings of the plaintiffs or from using in any other manner whatsoever the technical knowhow, specifications or drawings of the plaintiffs.


The Court restrained carrying on of any business including mail order business by utilizing the list of clientele/customers included in the database of the petitioner


(Question of ownership of copyright work)- On termination of employment, the defendant took away important confidential business data, such as client lists and proprietary drafts, belonging to the plaintiff. The defendants contended that, they were the owners of the copyright work as it was done by them during their employment since the relation between parties was not that of an employer and employee. The Delhi High Court rejected this contention and ruled that the plaintiff had a clear right in the material taken away by the defendant. Accordingly, the Delhi High Court restrained the defendant from using the information taken away illegally. It should be noted that the Delhi High Court did not prohibit the defendants from carrying on a similar service. The defendants were only restrained from using the information they took, as this was necessary to protect the interests of the plaintiff.


The Delhi High Court rejected this plea on the grounds that “The inconvenience caused to the defendant shall be much more in case the injunction as prayed by the plaintiff is granted in his favour”.

The Delhi High Court further observed that in order to claim copyrights, the plaintiff should have abridged, arranged and/or done something “which would show that they have done something with the material which is available in public domain so as to claim exclusive rights in that”.

[Allegation of theft for temporary removal of files by employee of Government] The Supreme Court held that even temporary removal of documents with a dishonest intention could cause loss or harm and hence, would be considered theft.


[Allegation of hacking by employer] The Court was of the view that the act of transferring or downloading various confidential information of the company into personal e-mail id. amounted to hacking under Section 66 of the Information Technology Act, 2000; cheating and dishonestly inducing of property under Section 420 of IPC and also amounted to criminal breach of trust under Section 406 of IPC.


[Legitimate recognition to Garden leave clauses] The court held that employee ought not, pending trial, to be allowed to do the very thing which his contract was intended to stop him doing, namely working for somebody else during the period of his contract.

18. VFS Global Services Private Limited v. Mr. Suprit Roy, 2008 (2) Bom. CR 446, 2008 (3) MhLj 266.

To obstruct on employee who has left service from obtaining gainful employment elsewhere is not fair or proper; [holding Garden Leave clauses in restraint of trade under Section 27 of The Contract Act, 1872]


[Claiming trade secret against employee as an intellectual property right] As per the facts as substantiated before the Delhi High Court, there was no agreement between Plaintiff and Defendant and further, Plaintiff had not made disclosure of material facts and had also not concealed information relating to the relation between Plaintiff and the competing company that Defendant had joined. Consequently, the Delhi High Court held that in any event, Plaintiff was not entitled to discretionary relief of injunction. The Delhi High Court further held that Plaintiff did not possess any exclusive intellectual property rights in respect of the products in dispute and hence there was no ground on which Plaintiff was entitled to injunction.

20. Microsoft Corporation v. Kai Fu Lee & Ors, 05-2-23561-6 SEA

Microsoft alleged that Kai-fu Lee who had intimate knowledge of the company’s trade secrets had violated a non-compete agreement by defecting to Google. Preliminary Injunction was granted against Lee from performing certain activities (eg: solicitation of Microsoft customers) while working with new employer Google.


The English Court of Appeal classified ‘confidential information’ into the following two categories: ‘highly confidential information’, which are entitled to protection after the termination of the employment relationship, and ‘less confidential information’ which are not so entitled.

22. Poeton Ltd v Horton, [2001] FSR 169

In creating the trinity of ‘trade secrets’, ‘highly confidential information’ and ‘less confidential information’, the Court came up with a new challenge for other courts to identify where an employee’s general knowledge ends and where the employee’s confidentiality begins.


[In relation to employee abruptly leaving the company] The Andhra Pradesh High Court held that such action by the Defendant did not cause any damage or loss to the company and it would be unreasonable to acquire such amount from the Defendant. An amount of Rs. 100, 000 was fixed by the court as reasonable damages taking into consideration the period of work and the fact that no actual loss was caused to the Company.


Reasonable damages awarded to employer for employees refusal to pay his medical expenses at the end of the five years of bond.
25. **Toshnial Brothers (Pvt.) Ltd. v. E. Eswarprasad & Ors, 1997 LLR 500**

Sudden termination of contract- The Madras High Court held that the employer was entitled to recover the stipulated damages, which is a genuine pre-estimate by the parties of the damages incurred. There is no requirement to prove separately any post-breach damages. The employer is required to establish that the employee was the beneficiary of special favour or concession or training at the cost and expense wholly or in part of the employer and there had been a breach of the undertaking by the beneficiary of the same. In such cases, the breach would per se constitute the required legal injury resulting for the employer due to breach of the contract.
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<table>
<thead>
<tr>
<th>TITLE</th>
<th>TYPE</th>
<th>DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jet Etihad Jet Gets a Co-Pilot</td>
<td>M&amp;A Lab</td>
<td>January 2014</td>
</tr>
<tr>
<td>Apollo’s Bumpy Ride in Pursuit of Cooper</td>
<td>M&amp;A Lab</td>
<td>January 2014</td>
</tr>
<tr>
<td>Diageo-USL ‘King of Good Times; Hands over Crown Jewel to Diageo</td>
<td>M&amp;A Lab</td>
<td>January 2014</td>
</tr>
<tr>
<td>File Foreign Application Prosecution History With Indian Patent Office</td>
<td>IP Lab</td>
<td>02 April 2013</td>
</tr>
<tr>
<td>Warburg - Future Capital - Deal Dissected</td>
<td>M&amp;A Lab</td>
<td>01 January 2013</td>
</tr>
<tr>
<td>Public M&amp;A’s in India: Takeover Code Dissected</td>
<td>M&amp;A Lab</td>
<td>August 2013</td>
</tr>
<tr>
<td>Copyright Amendment Bill 2012 receives Indian Parliament’s assent</td>
<td>IP Lab</td>
<td>September 2013</td>
</tr>
<tr>
<td>Real Financing - Onshore and Offshore Debt Funding Realty in India</td>
<td>Realty Check</td>
<td>01 May 2012</td>
</tr>
<tr>
<td>Pharma Patent Case Study</td>
<td>IP Lab</td>
<td>21 March 2012</td>
</tr>
<tr>
<td>Patni plays to iGate’s tunes</td>
<td>M&amp;A Lab</td>
<td>04 January 2012</td>
</tr>
<tr>
<td>Vedanta Acquires Control Over Cairn India</td>
<td>M&amp;A Lab</td>
<td>03 January 2012</td>
</tr>
<tr>
<td>Corporate Citizenry in the face of Corruption</td>
<td>Yes, Governance Matters!</td>
<td>15 September 2011</td>
</tr>
<tr>
<td>Funding Real Estate Projects - Exit Challenges</td>
<td>Realty Check</td>
<td>28 April 2011</td>
</tr>
<tr>
<td>Real Estate in India - A Practical Insight</td>
<td>Realty Check</td>
<td>22 March 2011</td>
</tr>
<tr>
<td>Hero to ride without its ‘Pillion Rider’</td>
<td>M&amp;A Lab</td>
<td>15 March 2011</td>
</tr>
<tr>
<td>Piramal - Abbott Deal: The Great Indian Pharma Story</td>
<td>M&amp;A Lab</td>
<td>05 August 2010</td>
</tr>
<tr>
<td>Bharti connects with Zain after two missed calls with MTN</td>
<td>M&amp;A Lab</td>
<td>05 June 2009</td>
</tr>
<tr>
<td>The Battle For Fame - Part I</td>
<td>M&amp;A Lab</td>
<td>01 April 2010</td>
</tr>
</tbody>
</table>
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